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Testimony of Mark G. Sklarz
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In SUPPORT of
H.B. 5259, "An Act Concerning Adoption of The Connecticut Uniform Limited Liability Company Act"

Judiciary Committee
February 29, 2016

Senator Coleman, Representative Tong and all Honorable Members of the Joint Judiciary Committee: Thank you for the opportunity to appear before the Judiciary Committee today.

My name is Mark G. Sklarz. I have been a private practitioner in Connecticut since 1970 and am "of counsel" in the New Haven office of the law firm of Day Pitney LLP. The focus of my practice is on business and corporate law and I am testifying today as the Chair of the Business Law Section of the Connecticut Bar Association as well as a member of the Section's Uniform Limited Liability Company Drafting Committee chaired so ably by Marcel Bernier of Murtha Cullina and David Levine of Cohen & Wolf. The Business Law Section includes over 600 Connecticut attorneys who are interested and involved in business and corporate law issues.

The Business Law Section strongly supports House Bill 5259, An Act Concerning Adoption of The Connecticut Uniform Limited Liability Company Act or "ULLCA" (the "Bill") which evolves from and is patterned after the Revised Uniform Limited Liability Company Act approved by the Uniform Law Commissioners of the American Bar Association (the "ULC Act") based upon years of study and analysis to modernize and address the most salient items regarding the business organization which over the last twenty five years has become the dominant entity used by small businesses.

Limited Liability Companies ("LLCs") were introduced in Connecticut with the enactment of the "Connecticut Limited Liability Company Act" in 1993 as a new entity to conduct business. In essence, a limited liability company is a hybrid between a corporation, affording limited liability to its owners (referred to as members), and a partnership, allowing a "pass-through" tax structure and avoiding double taxation without the eligibility limitations of an "S" corporation. Further, an LLC allows members substantial flexibility through contract (known as an operating agreement) between or among its members without governance and statutory formalities imposed upon a corporation. As a result, the statutory provisions governing LLCs are basically "default" rules, applicable to situations not addressed in an operating agreement. The combination of limited liability, favorable tax

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attributes, contractual flexibility and somewhat lower organizational costs has resulted in LLCs becoming the predominant business entity since its introduction into the law, particularly among small businesses.

The nationwide proliferation of LLCs as the primary entity to conduct business over the last two decades has created a body of law and experience which necessitates an update of the current Connecticut LLC act. Enactment of ULLCA by the General Assembly will achieve this objective and moreover support an important goal of the Business Law Section to adopt appropriate uniform acts which are intended both to create a business friendly environment and to provide common precedent and predictability through such uniform acts. This has been the case for example with the Connecticut Business Corporation Act and the Connecticut Uniform Limited Partnership Act and we consider ULLCA to be another in the important laws of such statutory codes. The Committee may recall most recently in this trend the enactment of the Connecticut Entity Transactions Act in 2011.

On behalf of the Business Law Section, we wish to thank the Committee for raising this critical Bill to reinforce and elevate Connecticut's position as a business friendly state and national leader of developing limited liability company law. I would also like to express gratitude for the enormous assistance of the ABA Uniform Law Commissioners and in particular Connecticut ULC Commissioner Attorney Barry Hawkins of Shipman & Goodwin in guiding our drafting Committee through many of the intricacies and policy aspects of the ULC Act. Finally, I would be remiss to fail to recognize publicly the extraordinary stewardship of our drafting committee co-chairs Marcel Bernier and David Levine and the enormous dedication of our committee members who met on a monthly and often semi-monthly basis over the past three and one-half years and spent countless hours scrutinizing and debating virtually every word and clause of this Bill to craft a law to provide Connecticut businesses, their customers and advisors with a high quality operating code.

An important component of enactment of a Uniform Law is to benefit from the expertise of the Uniform Law Commissioners and obtain the predictability of precedent that flows from the act while preserving the law that has been developed and worked well in Connecticut (the so-called "Connecticutizing" of the act). This was a particularly important process with ULLCA which as expressed above is in general what is referred to as a "default" act, i.e. the parties to a limited liability company operating agreement may in most cases by contract between or among them develop their own rules to govern their relationships but if items are not specifically addressed in the agreement, ULLCA will govern. It therefore became essential for the drafting committee to evaluate the probable expectations of the parties in such default situations based on current Connecticut law and include them in ULLCA. This was particularly pertinent in addressing Article 4 of ULLCA (sections 39 through 48 inclusive of HB 5259), and I would like to highlight a few of those provisions with the Committee this morning as follows (references are to the sections of HB 5259):

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- Section 39(c) of ULLCA changes current Connecticut law and follows the ULC Act to provide that after formation of a limited liability company, members may be admitted to the limited liability company only with the affirmative vote or consent of ALL members rather than with the affirmative vote or consent of a majority in interest of its members. Our committee and the Business Law Section agreed this would be consistent with the law of other jurisdictions, including Delaware, and protect the right of all members of an LLC to choose their member unless the LLC operating agreement specifically provides otherwise.

- Section 42(a) of ULLCA revises the ULC Act to provide that interim distributions (i.e. distributions prior to dissolution of the limited liability company) are to be distributed in proportion to unreturned contributions rather than on a per capita (equal) basis.

- Section 45 (b)(2) of ULLCA revises the ULC Act to provide that in a member-managed limited liability company, matters in the ordinary course shall be decided by a majority in interest of the members rather than a majority of the members.

- Section 45(b)(3) of ULLCA revises the ULC Act to provide that in a member-managed limited liability company, certain specified actions outside the ordinary course of business require an affirmative vote or consent of only two-thirds (2/3) in interest of the members rather than all of the members; provided however, Section 45(b)(4) retains the language of the ULC Act requiring an affirmative vote or consent of ALL members to amend an LLC operating agreement. While a change from current Connecticut law, this is the standard throughout the country, including Delaware, and our committee felt it was appropriate to protect all members of an LLC who had entered into an agreement by requiring unanimity to alter such agreement unless the agreement specifically states to the contrary.

- Section 45(c)(3) of ULLCA similarly revises the ULC Act to provide that in a manager-managed limited liability company, certain specified actions outside of the ordinary course of business require an affirmative vote or consent of only two-thirds (2/3) in interest of the members rather than all of the members with the qualification in Section 45(c)(4) that amendment of the LLC operating agreement requires an affirmative vote or consent of ALL of the members unless the LLC operating agreement provides otherwise.

- Section 46 of ULLCA revises the ULC Act to provide in general that the reimbursement, advance of expenses and indemnification provisions relating to limited liability companies follow the substantive provisions of the Connecticut Business Corporation Act (*CGS* sections 33-770 through 33-779). The Committee felt that harmony between the CBCA and ULLCA for similar matters presents a more consistent and coherent business law structure.

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- Sections 47(c)(1) and 47(i)(1) of ULLCA revise the ULC Act to provide that the standard for discharge of the duties of a member of a member-managed limited liability company and a manager of a manager-managed limited liability company will continue to be governed by the standard currently set forth in section 34-141 of the current Connecticut Limited Liability act and the standard proscribed in section 33-756 governing directors of a corporation, creating a somewhat higher standard than that required by the ULC Act. Our committee believed that such a standard was appropriate for managing members and managers and again felt the harmony and consistency of the CBCA and ULLCA standards provided a coherent business law structure.

- Section 47(f) of ULLCA revises the ULC Act to provide that certain actions which would otherwise violate the duty of loyalty may be authorized or ratified after full disclosure of all material facts by a majority in interest of disinterested members rather than all of the members.

Since the Uniform Law Commissioners have determined that none of the above proposed revisions of the ULC Act affects ULLCA from being substantially similar to the ULC Act, the Business Section believes ULLCA achieves the "best of both worlds" for the state of Connecticut, i.e. recognition of uniform law status and preservation of current Connecticut law favorable to and consistent with the conduct and expectations of LLC members in "default" situations.